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September 25, 2008

Ms. Anne Stausboll
Interim Chief Investment Officer
California Public Employees' Retirement System
400 Q Street
Sacramento, CA 95814

Re: Selection of External High Yield Fixed Income Managers¹

Dear Anne,

You requested Wilshire's opinion with respect to Staff's recommendations pertaining to the selection of eight managers (nine products) to a spring fed pool for high yield bonds and leveraged loans.

Recommendation

Wilshire recommends that the Investment Committee approve the addition of these managers to the pool. It should be noted that not all managers who are selected to go into the pool, will be immediately funded. The pool provides a mechanism for Staff to allocate assets to qualified firms based on their particular expertise and to provide back-up for the existing managers, should a change be necessitated. As always, Staff has the right to terminate the contracts of the managers with a pre-specified notice period should performance or organizational issue arise that would warrant termination.

Discussion

Wilshire worked extensively with Staff during this RFP process. Michael Schlachter, Thomas Toth, and I participated in the onsite due diligence meetings for every firm. In addition, Wilshire's Manager Research group, working in concert with your consulting team, conducted detailed due diligence on each manager and evaluated and scored each firm based on 1) the strength and stability of the organization, 2) the ability to gather and process information, 3) the ability to generate security level alpha forecasts based on that

¹ Wilshire's Code of Conduct requires us to disclose which of the above firms are clients of Wilshire's Analytics Services Division and as such pay Wilshire a fee for the licensing of analytical software used in investment management. Wilshire's consulting division has no business relationship with them. This disclosure has been delivered under separate cover.

information, 4) the ability to construct a portfolio designed to meet the goals of the CalPERS high yield program, in terms of both providing return and controlling risk, 5) the ability to effectively and efficiently implement a portfolio through trading, and 6) the ability to analyze their own performance, learn from it, and incorporate those lessons into the portfolio management process.

We find that each of the managers that have been recommended for the pool to have processes that can provide unique sources of return to the CalPERS high yield portfolio, have consistent and repeatable investment processes, and stable organization that appropriately align the firm's goals with CalPERS. Specific comments about each manager's processes are provided below.

Artio Global Management

Artio (formerly Julius Baer) manages using a global approach, seeking investments in US and non-US markets, primarily European. Artio builds portfolios using bottom up security selection combined with a top down macro view. The portfolio usually contains 60-100 issuers, which is a reasonably concentrated portfolio. However, as part of a larger portfolio, Artio's process provides diversification.

ING Investment Management

ING manages a high yield bank loan strategy. The portfolio is broadly diversified and fundamental research and covenant analysis drive the security selection. Sector allocations consider macro themes. ING uses its size to gain access and information on loan deals in the market.

JP Morgan

JP Morgan manages broadly diversified portfolios using bottom up techniques to identify relative value opportunities within the high yield bond market. The team seeks to identify companies with improving fundamentals that have yet to be broadly recognized by market participants. The High Yield team has access to research from across the entire organization, including equity analysts and economists.

Logan Circle

Logan Circle's portfolio management process is driven by security selection. The firm does not attempt to add value through sector rotation and relative sector weights are driven by security selection with some limitations in place for risk control. Logan Circle will opportunistically overweight B- and CCC-rated securities based on the team's view of the credit cycle, somewhat resembling a distressed bond manager in their pursuit of lower-rated / higher returning issues that bear a higher risk of default. Portfolios are typically very diversified, comprised of 150-175 issuers.

Putnam Investments

Putnam manages high yield bond portfolios in a highly systematic way, incorporating both quantitative and qualitative inputs into the process. Putnam's portfolios are broadly diversified, typically comprised of 150-250 different issuers and are managed with risk controls to typically constrain the tracking error to 2-3%. Although Putnam's CIO just announced his resignation, we feel that the high yield process will be unaffected.

RiverSource

RiverSource has two products: high yield bonds and bank loans. RiverSource's bond product is broadly diversified and the firm uses internal research to rank credits based on attractiveness and quality. Relative value drives the security selection process. RiverSource's loan product is also broadly diversified and focused on relative value within industries when selecting securities. In both cases, position sizes are determined by RiverSource's internal ranking methodology.

Simran Capital Management

Simran manages high yield bond portfolios using a "pre-event driven" strategy, which is focused on identifying stressed credits (trading between 50 and 90 cents on the dollar) and proactively engaging with corporate management to enhance bondholder value. Simran's strategy is somewhat capacity constrained by the relatively concentrated nature of the portfolio (30-60 positions) and the firm's focus on smaller issuers.

TCW Bank Loans

TCW manages its bank loan strategy with a focus on fundamentals, looking for companies with strong fundamentals operating in solid industries. Analysts are required to present information on downside protection during the investment process, which keeps the firm aware of the event-driven risks in the portfolio.

Conclusion

Wilshire concurs with Staff's recommendation to add these managers to the pool of high yield managers Staff can access. Recent market events seem to present opportunities in the high yield bond and levered loan spaces in the fixed income market for those managers with the ability to conduct thorough credit analysis and avoid the blowups in the market, or to pick among the lowest rated issues for bonds and loans that bear the most opportunity for recovery. We believe that these managers offer unique and complementary skills to the existing manager line-up, which should allow Staff to enhance the high yield portion of CalPERS fixed income portfolio

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Should you require anything further or have any questions, please do not hesitate to contact us.

Best regards,

A handwritten signature in black ink, appearing to read "Alan Jir". The signature is fluid and cursive, with the first name "Alan" and the last name "Jir" clearly distinguishable.